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SUBJECT: RUSSIAN ANTI-CRISIS MEASURES AND POST-CRISIS

REFORM: A CONVERSATION WITH MINISTER OF INDUSTRY AND TRADE
KHRISTENKO

REF: A. A) MOSCOW 541
[1](#)B. B) MOSCOW 334

Classified By: Amb. John Beyrle, Reasons 1.4 (b) and (d)

[1](#)1. (C) Summary. In a July 21 meeting characterized by wide-ranging and spirited interchange, Russian Minister of Industry and Trade Viktor Khristenko provided the Ambassador with his vision of Russia's anti-crisis measures and post-crisis reform. Khristenko noted that the crisis hit Russia hard, in part due to structural issues of the Russian economy. He stressed that, in responding to the crisis, the Russian government has remained true to its strategic economic goals, so that the anti-crisis measures will lead directly into the post-crisis reform--the tools may change but the goals remain the same. The Ambassador also used the occasion to raise several continuing trade irritants, including tariffs on off-road heavy equipment, combine harvesters and other agricultural equipment, and the situation of International Paper. For his part, Khristenko asked for information on the structure of the bilateral commission and encouraged U.S. participation in the Russian National Exhibition, scheduled for November in Chicago. End Summary.

[1](#)2. (C) On July 21, Ambassador Beyrle met with Russian Minister of Industry and Trade Viktor Khristenko. The meeting took place in Russian which, according to Khristenko's staff, provided the Minister with the opportunity to speak more openly than he customarily does with foreign representatives. The Ambassador summarized the outcome of what we viewed as a very productive summit, highlighting the decision to set up a bilateral commission, with working groups on trade and investment, energy and other issues. Khristenko informed the Ambassador that his strategy is to have good contacts with the Department of Commerce and that, as long as that happens, he believes that there will be no problem with the work in the Commission. (Comment: In other words, he can live with not being the head of the business and economic working group. End Comment.) He also urged that Secretary Locke travel outside Moscow on his next trip to Russia, to learn more about the country.

The Crisis

[1](#)3. (C) When asked for his views on the situation in the Russian economy and how the anti-crisis measures (many of which are carried out by the Ministry of Industry and Trade--MIT) had fared so far, Khristenko provided a frank and wide-ranging assessment. He acknowledged that Russia was hit harder by the crisis than many of the developed countries because of structural issues within the Russian economy. In

particular, the Russian economy remains based on commodities, which make up a substantial part of exports as well as overall industrial production. The steep drop in the price of commodities at the beginning of the crisis affected Russian companies' profits and investments. These declines then had a negative impact on budget revenues and employees' incomes, leading to a decrease in private demand.

14. (C) Khristenko noted that the crisis had two immediate impacts on Russia: price volatility and financial volatility.

Price volatility hit profits, and revenues declined significantly. Financial volatility hit Russian banking system hard, as Western banks reviewed their position on emerging markets and withdrew money. Khristenko argued that, as a result of these two phenomena, Russian GDP fell 10% in the first half of 2009 and industrial production declined by 15%.

15. (C) In describing the GOR response, Khristenko stated that government measures can only have a limited effect. That said, the GOR decided to focus its actions on two areas: (1) support for the financial system so that it would not pass on risks; and (2) support to the real sector, including actions to prop up private spending, investment and government demand. In his view, the GOR's anti-crisis measures did not reach the real sector until April or May 2009.

16. (C) According to Khristenko, the GOR continues to fine-tune its anti-crisis measures. He used the example of GOR actions in support of the Russian automotive sector. The GOR began with a program to subsidize financing for the purchase of automobiles which cost up to 350,000 rubles (about USD 12,000). The GOR also provided federal and local

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government agencies with funding and incentives to purchase vehicles produced in Russia. When that did not provide the desired results, the GOR took additional steps, including increasing the value of the cars which could be purchased using the special subsidy program from 350,000 rubles to 600,000 rubles. In addition, the required down-payment from the borrower was reduced to 15% of the vehicles value, and loans were made available for three years, instead of two.

17. (C) Even with these actions, Khristenko noted that the Russian automobile industry continues to suffer. Sales of new cars fell 55% in the first half of 2009, and production declined three-fold. Khristenko acknowledged that part of the decline in new car sales was due to the high volume of used car sales in 2008, just before higher import tariffs on used car imports took effect. He noted that, in 2008, used car sales reached 735,000 in Russia, which is a high amount given the overall size of the market. Half of these imported cars are right-hand drive, and used primarily in the Russian Far East. Khristenko argued that these gray imports of old technology hurt all producers in Russia, including GM and Ford. In tackling this problem, Khristenko stated that the GOR knew it was taking on the Far East Mafia and that it would not be easy. The mass inflow of used cars in 2008 led to overstocks that are still being sold off. That, combined with the crisis, produced a situation where new cars produced this year in Russia won't even start to be sold until later this month or in August, as producers and dealers are still selling off cars from previous years. Khristenko expects the issue will be discussed further when it is time to make the higher duties and restrictions on imports of used cars permanent. (For more information on the automobile situation, please see refs A and B.)

Anti-Crisis Response or Post-Crisis Reform

18. (C) In response to the Ambassador's query as to whether the GOR is planning any additional anti-crisis measures or is moving toward post-crisis reform, Khristenko said that they are doing both. The GOR is starting to see some positive

signals in a number of industries, but it is difficult to forecast anything now, because the current crisis in unprecedented in its scale. He also emphasized that there were no analogies to previous crises (in particular the 1998 crisis), because today's Russian economy is much more integrated into the global economy that was the case previously. Despite this uncertainty, the GOR needs to concentrate on what is really important. In recent years, MIT has been developing long-term strategies for key sectors.

They have set strategic industry goals and spelled out mechanisms for reaching these marks. Khristenko emphasized that, with the crisis, it is even more important to stay focused on these strategic goals, in order to avoid wasting the limited resources available. While the goals remain the same, the GOR is adjusting some of the mechanisms in response to new conditions created by the crisis.

¶9. (C) As an example of this process, Khristenko cited the SJ100 project, undertaken with support from Boeing. In Khristenko's view, it is an important project in a very sensitive sphere and it would have been easy to find a pretext for not doing it. The GOR had a general strategy for the aircraft sector to consolidate companies, clean them up, recapitalize them and then, in a very short period of time, have an IPO. Thus, the state will finance R&D, while IPO money will go for implementation of production plans. Khristenko observed, however, that an IPO makes no sense right now, so these will be delayed. That said, the IPO is just a tool or mechanism, not the goal itself, so while the tool might change, the goal remains the same--diversity of production and sales. He noted that they have similar plans for the helicopter and shipbuilding sectors.

¶10. (C) In discussing these issues, Khristenko highlighted flexibility. He argued that it is important not to be afraid to change or update decisions, as necessary. Returning to the automobile sector, he noted that it is still too early to tell whether the recent adjustments to the GOR program will produce the desired effect. It should become clear by mid-August.

The Irritants

¶11. (C) Off-Road Heavy Equipment: The Ambassador raised the

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issue of last year's increase in the tariff on trucks which also applies to certain off-road heavy equipment used in Russian industry but not produced domestically. Before the Ambassador could finish his points, Khristenko interrupted, stating that his Ministry supports making a separate customs code for off-road trucks to address the matter. He informed the Ambassador that MIT has already sent its recommendation to the Russian Interagency Commission on Safeguards and Customs Policy, headed by First Deputy Prime Minister Zubkov.

The final decision rests with the Commission, which will draft a GOR decision on the matter. Khristenko noted that MIT is the chief lobbyist in the Commission, but stated that, from a technical point of view, we should also talk with the Ministry of Economic Development (MED). (Note: The matter has been raised previously with MED personnel, who have been supportive on the issue in the past. Post will use meetings scheduled for next week to re-emphasize our continuing interest. End Note.)

¶12. (C) Combine/Harvesters: The Ambassador noted that the tariff increases on combine/harvesters constituted another trade irritant. He expressed appreciation for MIT's recent decision not to increase tariffs further, and noted that we would appreciate assistance in addressing the matter with Minister of Agriculture Skrynnik. Khristenko responded that agriculture was a sensitive issue for many countries, including the U.S. Especially during times of crisis, the state provides even more resources to support agriculture, as it would like to build a support chain "reaching all the way

to the ground." He stated that MIT has resources for the sector, but faces challenges putting plans in place. Khristenko noted that MIT has been funding R&D for Rosselmash since 2004, as the company develops its sixth-generation combine. He observed that, when he visited the area with PM Putin last November, they were horrified to see harvesters all over the city. With the crisis, there has been a complete stoppage in the purchasing of equipment. Khristenko acknowledged that the issue is politicized. In MIT's view, there is a need for production of this equipment in Russia, and that whatever product works best should be privileged in the market.

¶13. (C) John Deere: The Ambassador then raised the issue of John Deere and its recently announced plans for additional investment in Russia. Khristenko stated that, for John Deere, MIT is proposing to them the same industrial assembly regime as the one used in the automotive sector. He observed that Russia is a huge country with lots of undeveloped farm land. "Surely we must welcome such technology and encourage such cooperation here," he stated.

¶14. (C) VSMPO Avisma/magnesium: Khristenko used the opportunity to note that Russia, too, had trade irritants to raise with the U.S., including the dumping case on magnesium. He noted, however, that if we just meet every half year because we have to do so and keep telling each other of John Deere and magnesium respectively each time, we won't move any further until we end up with a lack of confidence. With that, he dropped the issue. (Note: Post understands that a team from MED is planning to meet with the Commerce Import Administration the week of August 3 on this issue. End note.)

¶15. (C) International Paper (IP): The Ambassador noted that IP was meeting the same day with the regional governor, as part of its efforts to obtain priority investor status. He requested MIT support for the request, when it is forwarded from the regional authorities to MIT for decision. Khristenko responded that MIT is aware of the case and is ready to support the request.

National Exhibition in Chicago

¶16. (U) Khristenko also used the opportunity to present the Ambassador with information, hot off the presses, about the Russian National Exhibition, planned for November 18-21 in Chicago. The Exhibition's theme is "Reset in Russian-US relations: changing ourselves, we change the world for the better." The Exhibition itself will have booths covering a wide range of topics, from the history of Russian-American relations to Russian industry; civil society; financial systems; medical centers and pharmaceuticals; science, innovation and venture projects. Organizers also plan a "vacancy fair" with information about jobs in the US and in Russia. Parallel to the Exhibition, organizers are putting together a series of conferences and seminars on themes such

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as "Nanoindustry and Nanotechnology;" "200 years of diplomacy: myths and reality in newer and newest history;" "Innovational Russia;" "Oil and gas: stable development of world economy, the role of Russia and the US;" and "Setting up a civil society." MIT is now officially in charge of organizing this event. The Ministry is currently working to ensure that it will be a "major event," with high-level GOR participation.

Comment

¶17. (C) The meeting was the Ambassador's first extended discussion with Khristenko, who was as open and voluble as we have seen him. (At one point, he even jovially cited a quote by Yogi Berra, "It's tough to make predictions, especially about the future.") Prior to the session, Khristenko's staff had made clear that the Ministry had been

instructed to work with the Americans. Khristenko spoke extensively on detailed issues without reference to notes. He displayed annoyance with having to deal with long-standing problems, such as combine/harvesters and John Deere. While making reference to the Ministry's goals to strengthen markets and provide the best product for consumers, he also made clear his interest in ensuring that industrial production expands in Russia, including production by U.S. and other foreign firms.

¶18. (C) This was the first detailed look we have had at the Chicago Exhibition in November, which was conceived as a trade fair, but has now clearly assumed more ambitious proportions. Several of our contacts have speculated that if the Exhibition lives up to these ambitions, it could serve as the platform for a visit to the U.S. by Prime Minister Putin.

End Comment.

BEYRLE